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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/07/05**	Bill No:	**AB 236**
Tax:	**Sales and Use**	Author:	**Bermudez**
Related Bills:	**SB 998 (Margett)**		

BILL SUMMARY

This bill would exempt from the sales and use tax, those gross receipts in excess of $0.632 per gallon on the sale or purchase of fuel and petroleum products to an air common carrier on a domestic flight. The provisions of this bill would sunset on January 1, 2010.

ANALYSIS

Current Law

Under existing law, Section 6385 of the Revenue and Taxation Code provides a sales tax exemption for that portion of fuel and petroleum products sold to a water common carrier that remains on board after the water common carrier reaches its first out-of-state destination. This section additionally provides a sales tax exemption for tangible personal property, other than fuel and petroleum products, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions.

With respect to air common carriers, Section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

Proposed Law

This bill would add Section 6357.7 to the Sales and Use Tax Law to provide an exemption from the computation of the amount of the sales tax on the gross receipts attributable to a sales price in excess of sixty-three and two-tenths cents ($0.632) per gallon from the sale of fuel and petroleum products to an air common carrier on a domestic flight. If enacted, only the first sixty-three and two-tenths cents ($0.632) per gallon when sold to an air common carrier for immediate consumption or shipment on a domestic flight would be subject to tax.

This bill defines the term “domestic flight” to mean a flight whose final destination is a point inside of the United States, including its territories.

This bill also defines the term “immediate consumption or shipment” to mean that the delivery of the fuel and petroleum products into an aircraft is made directly into an aircraft for consumption or transportation on a domestic flight and not for storage by the purchaser or any third party.

This bill would require the Board, beginning January 1, 2007, and annually thereafter, to submit a report to the Legislature on the state fiscal impact of the exemption.

The provisions of the bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill is enacted. The provisions of this bill would remain in effect until January 1, 2010, and as of that date would be repealed.

Background

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers’ common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by AB 2181 (Stats. 1991, Ch. 85) and SB 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615). Subsequent legislation extended the sunset date to January 1, 2014 (Ch. 712, SB 808, Stats. 2003).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. AB 3375 (Olberg) would have restored the exemption for rail common carriers. AB 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, “Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor’s proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements.” The Governor’s proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Three bills, similar to this bill, would have exempted from sales tax that portion of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination. AB 1800 (Machado), introduced during the 1998 Legislative Session, failed to pass the Assembly Appropriations Committee. AB 2470 (Wiggins), introduced during the 2000 Legislative Session, failed to pass the Assembly Revenue and Taxation Committee. SB 1510 (Knight), introduced during 2002 Legislative Session, died in Senate Revenue and Taxation Committee.

AB 2897 (Wiggins), introduced during the 2002 Legislative Session, would have exempted from the sales and use tax, those gross receipts in excess of $0.50 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was held under submission in the Assembly Appropriations Committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Air Transport Association to create an exemption for sales of fuel to air common carriers since the exemption previously afforded to sales of fuel to air common carriers was repealed in 1991 due to budget constraints. According to the sponsor of the bill, the state's high tax rate, coupled with the excessive cost of fuel per gallon, is having a dramatic impact on the airline industry's activities in California.

2. **Exemption may be difficult for aviation fuel retailers/suppliers to administer.** This bill would provide a partial sales and use tax exemption for fuel and petroleum products sold to or purchased by an air common carrier for immediate consumption or shipment on a domestic flight. This bill would exempt the sales price in excess of $0.632 per gallon. Only the first 0.632 per gallon would be subject to tax.

Exempt	**Taxable**
> $ 0.632 per gallon	*< $ 0.632 per gallon (*less than or equal to)

   The proposed exemption could be difficult to administer because only a portion of the sales price per gallon is exempt. Because the price of fuel is volatile, the exempt receipts could constantly change, which could lead to difficulties for retailers in collecting the correct amount of tax and could also result in reporting errors on sales and use tax returns.

3. **The Board would not have actual data of exempt aircraft fuel sold to air common carriers.** This bill would require the Board, on January 1, 2007, and annually thereafter to submit a report to the Legislature setting forth the state fiscal impact of the exemption. Under current reporting requirements, the Board does not obtain this information. There is no separate line on the sales and use tax return for exempt sales of aircraft fuel. Only the most common tax expenditures allowed under the Sales and Use Tax Law are separately identified on the sales and use tax return. For fuel suppliers/retailers that make both taxable and exempt sales, only the taxable sales are reported on the return.

   The Board can estimate the revenue impact of a tax expenditure. However, the Board generally uses independent data sources, rather than tax returns, in preparing the revenue estimates.

4. **Related Legislation.** Senate Bill 998 (Margett), operative January 1, 2008, would exempt from the sales and use tax that portion of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination.

COST ESTIMATE

Some costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, and answering inquiries from industry and the public. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

According to the U.S. Energy Information Administration (EIA), total sales of jet fuel in California for the year 2003 were 3.55 billion gallons. According to the Bureau of Transportation Statistics, total gallonage consumed in the U.S. in 2003 was 17.8 billion gallons. The fuel consumed by international flights was 4.8 billion gallons, which comprises 27 percent (4.8 billion gallons / 17.8 billion gallons) of jet fuel consumed.

Currently, expenditures on fuel for international flights are exempt from sales and use tax. Assuming that jet fuel usage in California is consistent with the national average, the fuel used for domestic flights is estimated to be 2.55 billion gallons (3.5 billion gallons X 73 percent). For 2004, the price of jet fuel in California was $1.278 per gallon. This bill would exempt that portion of the price over $0.632 per gallon, or $0.646 per gallon. Therefore, the total annual expenditures that qualify under this bill are estimated to be $1,650 million (2.55 billion gallons x $0.646).

Revenue Summary

The revenue impact of exempting $1,650 million annually from the sales and use tax is as follows:

	Revenue Effect
State loss (5.25%)	$ 86.6 million
Local loss (2.00%)	$ 33.0 million
Special District loss (0.67%)	$ 11.1 million
Total loss	$130.7 million

Qualifying Remarks

The price of petroleum is extremely volatile. The estimate above is based upon an annual average of the most recent prices for 2004 in California. National jet fuel usage shows annual increases until 2001. The calendar years of 2002 and 2003 show usage relatively even but far below 2001 levels.

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